The Nature and Method of Economics

PRINCIPLES OF ECONOMICS (ECON 210)
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What students will learn in this class

• The economic way of thinking.
  • The most valuable skill students will practice.
  • A broadly applicable method of explaining human behavior, individually and collectively.
  • Economics is a social science.

• Also tools to describe models (testable predictions about human behavior), express thoughts:
  • Vocabulary to describe models concisely and accurately,
  • Graphing skills used to illustrate a model’s assumptions and implications,
  • Arithmetic to derive quantifiable implications of models.
The Economic way of thinking

• **Scarcity and choice.** The basic problem: allocating limited resources among unlimited wants.
  • Choice solves the problem by allocating resources to some wants instead of others.
  • Economists study the bases for choices and the consequences of the resulting allocations.

• **Rational behavior** differentiates economics from other social sciences.
  • People as purposeful seekers of their wants—whatever they may be.
  • Attempt to fulfill their wants as amply as possible, given the constraints of scarcity.
  • They behave as if trying to accomplish some objective to which their choices move them closer.
The Economic way of thinking

• Marginalism. Rarely do choices require revisions to one’s entire life plan, more often only small “tweaks”: small incremental changes. Examples:
  • “Buy a new car today or wait another month?”
  • “16 oz. pack of cheese or 24 oz. pack?”
  • “Play golf or play basketball on Saturday?”

• These all involve “one more” or “one less” of something, taking the broader plan as given. The calculation is based on marginal benefits and marginal costs. I.e.,
  “What do I get from 1 more?”
  “What do I have to give up to get 1 more?” and
  “Is it worth it?”
Economics principles’ origins: the scientific method

• **Observe** the real world and record facts.
  • E.g., “when workers quit a job, the new job they accept usually has a higher wage.”

• **Form a hypothesis.**
  • “Workers quit because they searched for and found a better job, and ‘better’ usually includes a higher wage.”

• **Test** the hypothesis. Compare its prediction to observed outcomes.
  • E.g., “Does the introduction of a search engine that makes vacancies easier to find increase quitting?”
  • Corollary. A valid test is conducted in a ceteris paribus environment. Other factors affecting quit behavior are explicitly or statistically controlled, as in a laboratory setting.

• Confirm or reject the hypothesis. Modify the rejected hypothesis if possible and repeat step 3.

• As repeated tests confirm predictions, a **theory** evolves.

• Theories that gain wide acceptance and favorable test results evolve into economic laws or **principles**.
Organizational structure: micro vs. macro

Research is focused on one or two specific fields at a time. The most famous way of sub-dividing studies is based on micro or macro.

- Microeconomics analyzes the choices of individual households or firms within specific markets.
- Macroeconomics analyzes the performance of an economy overall—the aggregation of many households, firms, and markets.
Organizational structure: the JEL codes

A more colorful way of illustrating the areas economists focus on. The American Economic Association made the JEL (Journal of Economic Literature) system to classify economic research more descriptively.

• Other classes in our department, e.g., “International,” “Industrial Organization,” and “Labor Economics.”
  • The sub-fields within each of these gives an even better picture of what each field studies.
  • They may also be useful for choosing other economics electives, based on a student’s interests.

Theoretical and empirical.

• Fields can be further divided according to the formulation and testing of hypotheses:
  Formulation → Theory
  Testing → Empiricism.
Conclusion

This class:

• Primarily theory.
  • Methods used in empirical economics are taught in other classes: statistics and econometrics.

• Emphasizes microeconomic theory over macroeconomics.
  • The former is the building block of the latter. It is possible to learn many useful insights about behavior without aggregating to the macro level; the reverse is not true.

• Wherever possible we will explore applications to current events, policy discussions, and students’ stated interests.